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In the Supreme Court
of the United States

October Term 1964

No. 63

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

CLAY B. BROWN and DOROTHY E. BROWN, DONALD L. BROWN and INGRID R. BROWN, CHARLES WILLIAM BOOTH and NANCY H. BOOTH, DONALD LEE BROWN, PHILLIP F. BROWN, MARILYN BROWN,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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In the Supreme Court of the United States

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No. 1041

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CLAY B. BROWN and DOROTHY E. BROWN, DONALD L. BROWN and INGRID R. BROWN, CHARLES WILLIAM BOOTH and NANCY H. BOOTH, DONALD LEE BROWN, PHILLIP F. BROWN, MARILYN BROWN,
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OPINIONS BELOW

The findings and opinion of the Tax Court (R. 17-81) are reported at 37 T.C. 461. The opinion of the Court of Appeals (R. 140-145) is reported at 325 F.2d 313.

JURISDICTION

The judgments of the Court of Appeals were entered on December 10, 1963 (R. 146). The petitioner requested and received extensions of time for filing a petition for certiorari from Mr. Justice Douglas on March 11, 1964 and April 3, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether there is compliance with the "sale" prerequisite for long term capital gain where corporate stock is transferred outright to a tax-exempt institution for a fixed price within a reasonable range negotiated in an arms-length transaction, payable over a period of years secured by a mortgage on the underlying assets and by a management contract; or whether compliance with the "sale" prerequisite is nullified by the fact that the tax-exempt institution assumes no personal liability for payment of the purchase price and injects no funds of its own into the transaction thereby making payment of the purchase price dependent upon the earnings from, and value of, the assets transferred.

STATUTE INVOLVED

Sec. 1222 (3) of the Internal Revenue Code of 1954 (26 U.S.C., 1958 Ed) provides that:

> "The term 'long term capital gain' means gain from the sale or exchange of a capital asset held for more than six months * * *."

STATEMENT

As related by petitioner, the Tax Court made detailed findings of fact. (R. 18-57). The abbreviated statement of the facts made by petitioner at pages 3 through 5 of the petition is substantially similar to the summary of facts contained in Petitioner's opening brief to the Court of Appeals and is quoted in the Court of Appeals opinion with certain additions (R. 141-143) which the Circuit Court deemed necessary to accurately reflect the findings of the Tax Court. These supplemental findings added by the Court of Appeals include those quoted below:

> " * * *There was considerable bargaining [between respondents and the Institute] and a price was agreed upon that was within a reasonable range in light of the earnings history of the corporation and the adjusted net worth of its assets." (R. 141)
>
> "* * * there was a change of economic benefits in the transaction (R. 143).
>
> "* * * the primary motivation of the Institute was the prospect of ending up with the assets free and clear after the purchase price had been fully paid, which would then permit the Institute to convert the property into money for use in cancer research." (R. 143)

ARGUMENT

There is no conflict between the Courts of Appeals on the issue presented, and none is alleged by petitioner in his statement of the question. Nevertheless, petitioner submits in his argument that there is a basic conflict of principle between the decision below and that of the

Seventh Circuit in *Kolkey* v. *Commissioner*, 254 F.2d 51 (Br. 20). To support this decision, petitioner makes the following statement (Br. 20):

> "* * * But that was not the rationale of the *Kolkey* opinion, and in every bootstrap sale the "purchase price" is necessarily wholly arbitrary—being determined only by tax considerations * * *".

Similar statements permeate Petitioner's argument as disclosed by the following quotations therefrom:

> "On the other hand, neither economics nor fairness imposes an upper limits on the price" (Br. 9).

> "There being no economic determinations of the price, the upper limit can be determined only by tax considerations" (Br. 10).

> "The price is not determined by economic forces and is necessarily greater than the cash value of the business * * *." (Br. 17-18.)

> "The bootstrap sale of business to charity is an transaction that has no reason for being other than tax avoidance." (Br. 33.)

All of these statements make it clear that the purported tax evil which petitioner desires to remedy through his petition is a bootstrap sale where the purchase price is wholly arbitrary and is determined only by tax considerations. All of these statements by Petitioner conflict with the findings and the conclusions emphasized by the Court of Appeals below, which findings and conclusions are quoted under respondent's statement, and are repeated below:

> "* * * There was considerable bargaining [between respondents and the Institute] and a price was agreed upon that was within a reasonable range in light of the earnings history of the corporation

and the adjusted net worth of its assets." (R. 141)

"* * * there was a change of economic benefits in the transaction (R. 143).

"* * * the primary motivation of the Institute was the prospect of ending up with the assets free and clear after the purchase price had been fully paid, which would then permit the Institute to convert the property into money for use in cancer research." (R. 143)

The instant case just does not involve a bootstrap sale where the purchase price is wholly arbitrary, determined only by tax considerations.

Instead of having a conflict in principle between the decision of the Seventh Circuit in *Kolkey* and the decision below, we have: (i) a decision by the Seventh Circuit which affirmed the decision of the Tax Court that there was no "sale" to a charitable institution qualified for long term capital gain treatment where the purchase price was arbitrary and determined primarily by tax considerations, and (ii) the decision of the Court of Appeals below affirming the decision of the Tax Court that there was a "sale" entitled to long term capital gain treatment where the price was within a reasonable range resulting from considerable bargaining at arms length with a charitable institution primarily motivated by the prospect of ending up with the assets free and clear after the purchase price had been fully paid, which would then permit the charitable institution to convert the property into money for use in its charitable endeavors. The rule applied in *Kolkey* was similarly applied here—whether under all the facts and circumstances the motive or intention of the parties was to

effect a sale. This is a question of fact and each case will be determined based upon its own particular circumstances. As the Tax Court has indicated in *Anderson Dairy, Inc.* v. *Commissioner*, 30 T.C. 1027, (1963):

> "The problem of determining the *true motive of a purported sale of property* to a tax exempt corporation where the tax exempt corporation in turn leases the property to a newly formed corporation in which the original owners have an interest has arisen recently in several cases. *Estate of Ernest G. Howes*, 30 T.C. 909 (1958), Affd. Sub. Nom. *Commissioner* v. *Johnson*, 267 F.2d 382 (C.A. 1, 1959); *W. H. Truschel*, 29 T.C. 433 (1957); *Emanuel N. (Manny) Kolkey*, 27 T.C. 37 (1956) Affd. 254 F.2d 51 (C.A. 7, 1958); *Union Bank* v. *United States*, 285 F.2d 126 (Ct. Cl. 1961); *Clay B. Brown*, 37 T.C. 461 (1961), on appeal (C.A. 9, June 25, 1962). These cases have reached varying results on the issue. *Since the issue is one of fact*, it is apparent that precedents provide no ready answer." (emphasis supplied)

Perhaps petitioner's attempt to emphasize the importance of the issue is motivated by his knowledge of situations existing in the backlog cases referred to in his brief. Respondents have no knowledge concerning this. However, it is respectfully submitted that the solution consistent with Rule 19 is to wait until a Court of Appeals sustains long term capital gain in a sale to a charity where the price is wholly arbitrary and is determined solely or primarily by tax considerations. It may be assumed that the Tax Court will continue its astuteness in distinguishing the facts in *Kolkey* type sales from those involved in the instant case. Even if a lower court having initial jurisdiction should go astray and sustain

capital gain in a *Kolkey* type sale, there is nothing in the present decisions to indicate that the appropriate Court of Appeals would not cope with the matter.

Should a conflict ever develop between Courts of Appeals, the problem presented might be something for consideration by Congress rather than this Court, particularly since the root of the evil, according to petitioner, lies in the tax exempt status of the purchaser. Denying capital gain to the seller is a rather indirect way of remedying any misuse by tax exempt organizations of their tax exemption. As suggested by the Court of Appeals below at the conclusion of its opinion, (R. 145) if any undesirable situation does exist, the solution is for Congress to amend the provisions of the Internal Revenue Code relating to the income and tax exempt status of the purchasing institution, particularly in view of the fact that the problem of misuse by tax exempt organizations of such exemption in transactions similar to the one here presented, was considered by Congress which adopted certain remedial legislation in the Revenue Act of 1950.

In his conclusion, petitioner asserts that the ruling of the Court of Appeals below was unpalatable to the court, evidently because of the Court's reference to Congress as the proper body to afford any remedy that may be appropriate. The Court below does not in any way indicate a dissatisfaction with the result of its holding. The Court's reference to Congress as the proper remedial body follows the prefacing clause:

"If, as is indicated by the writers of the articles

> cited at the beginning of this opinion, the present situation, insofar as the tax position of the sellers is concerned, it is undesirable from a tax standpoint * * *"

The tax articles referred to are likewise cited in petitioner's argument to this Court (Br. 10). The theme behind these articles is illustrated by the following quotation from *Sales, Churches and Monkeyshines*, 11 Tax Law Review 87 (1956) at page 100:

> "To put the matter into proper focus, a case of a valid sale to a church should be stated. To obtain unquestioned validity, as many as possible of the dangerous factors must be obviated. *An abnormally high purchase price is economically essential to the transaction;* thus the taxpayer commences with one adverse factor." (Emphasis added).

As pointed out by respondents in their brief to the Court of Appeals, the Institute never mentioned during the negotiations that the respondents were entitled to an abnormally high purchase price. If it had, there would have been no bargaining at arm's length resulting in a price that was within a reasonable range in the light of the earnings history of the corporation and of the adjusted net worth of its assets. Again, we find that the instant case does not furnish the platform for the scope of review which petitioner is seeking.

Once it is established that the fixed purchase price was within a reasonable range and that the transaction was an arms-length one, the only remaining objection of the petitioner must relate to the security taken from

the Institute by the respondents.[1] It is difficult to determine whether the petitioner is objecting because the respondents took too much security (a mortgage on the plant and equipment and a management contract) or too little (small down payment and payments geared to earnings). If it is the latter, it is difficult to understand how petitioner gets any solace from the depletion and patent cases, since the courts have consistently allowed capital gain treatment to a seller of mineral rights or patent rights, where the security, if any, was limited to the intangible represented by the patent or the hoped for but undeveloped mineral deposit, and the purchase price was completely unknown and limited to payments from earnings. See cases cited by petitioner in Fn. 23 (Br. 21) and *Barker* v. *Commissioner*, 250 F.2d 864 (CA 5, 1957); *U.S.* v. *Giustina*, 313 F.2d 710 (C.A. 9, 1962); and *Crowell Land and Mineral Corp.* v. *Commissioner*, 242 F.2d 864 (C.A. 5, 1957). It has not even been necessary for the seller to be divorced from an interest in the purchasing corporation. *Mayer* v. *U. S.*, 285 F.2d 648 (C.A. 9, 1960).

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[1] Petitioner can have no real objection to the fact that the buyer does not have personal liability and that the purchase price is secured only by physical assets with a known history of earnings. It is submitted that most sales of investment property are made to buyers who do not assume personal liability and necessarily rely on the future earning capacity of the asset. Indeed, many states by statute forbid personal deficiencies against buyers in sales of real or personal property which may have little or no income producing potential. See for example, Oregon Revised Statutes Sec. 88.070 and California Code of Civil Procedures Secs. 726 and 580 (b).

CONCLUSION

Petitioner's argument attacks a transaction involving an arbitrary purchase price determined solely by tax considerations. This case, however, involves an arms-length purchase for a reasonable price motivated primarily by considerations divorced from the tax consequences of the sale. Thus the federal question which petitioner asserts to be important is not even presented by this case.

Admittedly there exists no conflict with decisions of this Court or between decisions of Courts of Appeals.

It is submitted that under Rule 19 of this Court the petition for writ of certiorari should be denied.

Respectfully submitted,

ROBERT T. MAUTZ